

**Letter of Findings: 02-20100625**  
**Corporate Income Tax**  
**For the Years 2007, 2008, and 2009**

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**ISSUE**

**I. Sales Factor Numerator – Corporate Income Tax.**

**Authority:** [45 IAC 3.1-1-50](#)(4)

Taxpayer disagrees with the Department's decision requiring it to report its gross income based on the specific location of the equipment it rents to its customers.

**STATEMENT OF FACTS**

Taxpayer is an out-of-state company in the business of selling, leasing, and financing computers and software. Taxpayer rents computer equipment to Indiana customers and receives income from those Indiana customers. Taxpayer also leases computers to out-of-state customers.

The Department of Revenue (Department) conducted an income tax audit of Taxpayer's business records and tax returns. The audit resulted in the assessment of additional corporate income tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

**I. Sales Factor Numerator – Corporate Income Tax.**

**DISCUSSION**

Taxpayer rents computers to customers inside Indiana and outside Indiana. Taxpayer explained the manner in which it keeps track of what income comes from what state.

[Taxpayer] lease[s] equipment throughout the United States primarily to large corporate customers. We compute our sales apportionment factor based on where the equipment is located. The rationale for this is that the lease income is directly related to where the equipment is located and the amount of equipment located in each state. Based on this relationship a ratio is established and this ratio is applied to total gross receipts. This is our established method used for all state income tax filings. This method was adopted because it is the only way we have of accurately determining the proper sales allocation.

The Department's audit found fault with this methodology as follows:

Auditor reviewed the taxpayer's apportionment schedules and supporting documents and detail. Auditor also reviewed taxpayer's ST-103 returns and found discrepancies between the sales amounts reported on taxpayer's apportionment schedules. Auditor adjusted the sales numerator for each year under audit. Taxpayer explained to auditor that they use an apportionment calculation based upon equipment cost.

As a result, the Department cited [45 IAC 3.1-1-50](#)(4) for authority to adjust Taxpayer's sales numerator. That portion of the regulation states:

If the taxpayer is in the business of renting real or tangible personal property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.

The issue is whether Taxpayer's method of allocating income based on "location" of the equipment is correct or whether the Department's method – based on Taxpayer's sales tax returns – is correct.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." (Emphasis added).

Taxpayer objects to the audit's reliance on the sales tax it paid Indiana. Taxpayer states that for certain of its leases, it collects all the sales tax at the beginning of the lease term. For example – and for illustrative purposes only – Taxpayer may enter into a three-year lease agreement for \$1,000 per year. At the onset of the lease, Taxpayer may collect sales tax on the entire \$3,000 it expects to collect and forwards \$210 to the Department. Taxpayer points out that the customer may cancel the lease before the end of the three-year term is complete in which case it will only receive a portion of the \$3,000 it originally expected to collect.

Taxpayer objects for a second reason; the Department's audit reviewed 2007, 2008, and 2009. Taxpayer points out that – based on the example cited in the preceding example – Taxpayer may have reported the \$210 in sales tax during 2009. Even assuming that the customer did not cancel the three-year lease, the Department's methodology would have imputed the entire \$3,000 received to 2009 the year in which it reported the sales tax even though the actual lease payments would have been received during two years – 2010 and 2011 – which are outside the audit period. However, the corollary should be pointed out; it is equally possible that Taxpayer reported the \$210 in sales tax during 2006 but received the income during 2007 and 2008 amounts which – under

Taxpayer's methodology – would have gone unreported as Indiana source income.

Taxpayer states it calculates its income based upon the location and value of the equipment. However, Taxpayer's methodology is also open to similarly imprecise results. For example, Taxpayer may lease a computer worth \$5,000 to an Indiana customer and a computer worth \$10,000 to an Ohio customer. Based on Taxpayer's method of apportioning the income from these two leases, twice as much income should be apportioned to Ohio because the Ohio computer is worth twice as much as the Indiana computer. However, there is nothing which established that it receives twice as much income from the Ohio customer compared to the Indiana customer. There is no direct correlation between the amount of lease income Taxpayer attributes to a computer to the value of that particular computer.

The issue is whether Taxpayer met its burden of proving that the audit's assessment is wrong as required under IC § 6-8.1-5-1(c). The Department is unable to agree that Taxpayer has met its burden of doing so. Taxpayer's concerns are not irrational or unfounded. Taxpayer has simply presented an alternative to the audit's method of determining the gross receipts it receives from its customers, but it has not met its burden of demonstrating that the assessment is wrong.

#### **FINDING**

Taxpayer's protest is respectfully denied.

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